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## Derivative Stockholder's Suits in West Virginia

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ware corporation laws take heed of its burdens. To base limitations on power of amendment on the latter principle would be to penalize stockholders for the sins of the corporation, for the average investor does not investigate the laws of the incorporating state.

F. W. L.

### DERIVATIVE STOCKHOLDER'S SUITS IN WEST VIRGINIA

Our courts have shown no inclination to depart from the rules laid down by the cases which are generally recognized as authority in this country. Statutes have played little or no part in the development of this topic in West Virginia, and it is probable that a consultation of the leading texts<sup>1</sup> will give as accurate a picture of the future position of the court as any case study. The chief difficulty lies in the fact that the subject of stockholder's suits, while very important, is not a very controversial one, and where the authorities split we are as likely to follow one side as the other, and it is not easy to make a prediction in these cases on the basis of a general attitude or trend.

There are about a dozen leading cases in this state, a study of which will perhaps help to clarify the general outlines of the subject, and to determine our court's probable approach to any new problem in it.

1. *Who May Sue.* If the suit involves dissolution of the corporation not less than one-fifth in interest of the stockholders must sue under our statute,<sup>2</sup> but a receiver may be appointed for sufficient cause at the suit of any stockholder. In general it seems

<sup>1</sup> FLETCHER, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS (Rev. ed. 1931); THOMPSON, CORPORATIONS (3rd ed. 1927); COOK, CORPORATIONS (8th ed. 1923). These texts are cited in almost all the West Virginia cases on stockholder's suits.

<sup>2</sup> W. VA. REV. CODE (1931) c. 31, art. 1, § 81. The court has been rather strict in requiring good cause to be shown for the application of this statute. *Ward v. Hotel Randolph Co.*, 65 W. Va. 721, 63 S. E. 613 (1908); *Robinson v. Weimer-Warren Co.*, 110 W. Va. 143, 157 S. E. 85 (1931); *Law v. Rich*, 47 W. Va. 634, 35 S. E. 858 (1900). See also *Kyle v. Wagner*, 45 W. Va. 349, 32 S. E. 213 (1898).

<sup>3</sup> W. VA. REV. CODE (1931) c. 31, art. 1, § 82. See also on the appointment of receivers for corporations, *id.* c. 56, art. 6, §§ 1, 2.

<sup>4</sup> *Maxon's Adm'x v. Maxon-Miller Co.*, 53 W. Va. 150, 44 S. E. 131 (1903); *Tierney v. United Pocahontas Coal Co.*, 85 W. Va. 545, 102 S. E. 249 (1920); *Campbell v. King's Daughter General Hospital*, 96 W. Va. 539, 123 S. E. 396 (1924). 13 FLETCHER, CORPORATIONS § 5975. But see 6 THOMPSON, CORPORATIONS § 4576.

that any stockholder may bring a derivative suit, irrespective of the size of his holdings.<sup>4</sup> An equitable owner of stock may sue.<sup>5</sup>

2. *Who Must Be Parties.* Since the corporation has a legal interest in the subject matter of the suit, which will be adjudicated, it is a necessary party to the suit, and failure to join it is a ground for demurrer.<sup>6</sup> However, the corporation is not an indispensable party, and where it is insolvent and has *de facto* ceased to exist, or is disabled to act by the misconduct of its agents, or in the case of some other fact rendering the interest of the corporation formal only, failure to join it will be excused.<sup>7</sup> Of course, all those who would normally be necessary parties to an equity suit involving the same subject matter must be joined.<sup>8</sup>

3. *Prerequisites to Starting the Suit.* It is apparent that suit by one who has no title himself to the claim sued on, is a type of extraordinary relief, permitted only in a narrow category of cases. In this light the many conditions precedent to the exercise of this remedy are natural restrictions.

In order to bring this type of suit there must be a cause of action belonging to the corporation, which it refuses to exercise, and which refusal causes injury to the plaintiff as a stockholder. The suit must of course be in equity, even though the corporate right of action is a legal one, since the plaintiff does not have legal title to it.<sup>9</sup>

Before a stockholder may maintain this suit he must allege and prove notice to the directors of the corporation, demand upon them to exercise the corporate right of action, and refusal by them to do so, and similar demand, notice and refusal as to the stockholders. This notice is not necessary where the directors, or the controlling stockholders, are so connected with the wrong that the affairs of the corporation cannot safely be left in their hands. Such

<sup>4</sup> *Felsenheld v. Bloch Bros. Tobacco Co.*, 192 S. E. 545 (W. Va. 1937); 13 FLETCHER, CORPORATIONS § 5976.

<sup>5</sup> *Nimick v. Mingo Iron Works*, 25 W. Va. 184 (1884); *Crumlish's Adm'r v. Shenandoah Valley R. R.*, 28 W. Va. 623 (1886); 13 FLETCHER, CORPORATIONS § 5997; 6 THOMPSON, CORPORATIONS § 4650.

<sup>7</sup> *Steenrod v. W. P. & B. R. R.*, 27 W. Va. 1 (1885); *Crumlish's Adm'r v. Shenandoah Valley R. R.*, 28 W. Va. 623 (1886); *Kyle v. Wagner*, 45 W. Va. 349, 32 S. E. 213 (1898); 13 FLETCHER, CORPORATIONS § 5997. But see 6 THOMPSON, CORPORATIONS § 4650 *contra*, citing *Mount v. Radford Trust Co.*, 93 Va. 427, 25 S. E. 244 (1896).

<sup>8</sup> 13 FLETCHER, CORPORATIONS §§ 5996-6002; 6 THOMPSON, CORPORATIONS §§ 4649-4655; *Upton v. Southern Produce Co.*, 133 S. E. 576 (Va. 1926).

<sup>9</sup> *Moore, Pres. v. Schoppert*, 22 W. Va. 282 (1883); *Rathbone v. Gas Co.*, 31 W. Va. 798, 8 S. E. 570 (1888); 13 FLETCHER, CORPORATIONS §§ 5945-5956.

excuse must appear clearly before the court will act, and it seems that a safe practice would be to give notice anyway.<sup>10</sup>

4. *Bars to the Suit.* Many authorities require that the plaintiff be free from any complicity in the wrong sued on, and that he be a stockholder at the time of such wrong, or a purchaser from one who was an innocent holder at that time. There are several possible rules on this point, varying considerably in strictness.<sup>11</sup> No West Virginia cases were found on the point. It is submitted that the suit would probably be allowed here, if the plaintiff were himself innocent of any connection with the wrong.

Laches is another possible bar, but it has been held that the Statute of Limitations does not apply, even by analogy, although a legal claim is sued on, and that laches must be shown *after* the plaintiff knew all the facts, was in a position to act, and should reasonably have done so. The doctrine of laches will not usually be applied unless some of the parties have died, the rights of third parties have intervened, or loss of evidence has resulted from the plaintiff's delay.<sup>12</sup> If the corporation would have been barred, there is a complete bar to the suit.

5. *Grounds for the Suit.* According to definition and authority this suit may be used to enforce any right of action of the corporation when it refuses to do so. But, practically, almost all cases involve a wrong to the corporation by officers, directors, or stockholders; otherwise the corporation would probably exercise its rights. In most cases, then, the grounds will be misconduct of directors or stockholders, not falling under the categories of non-reviewable directorate or stockholder action. In cases of directorate misconduct, any action involving misappropriation of funds and dissipation of capital will usually suffice.<sup>13</sup> In case of wrongful

<sup>10</sup> No appeal is necessary where the corporation is entirely in the control of the wrongdoers. *Moore v. Lewisburg & R. E. R. R.*, 80 W. Va. 653, 93 S. E. 762 (1917); *Rathbone v. Gas Co.*; *Moore, Pres. v. Schoppert*, both *supra* n. 9; *Crumlish's Adm'r v. Shenandoah Valley R. R.*, 28 W. Va. 623 (1886); *Smiley v. New River Co.*, 72 W. Va. 221, 77 S. E. 976 (1912); *Ward v. Hotel Randolph Co.*, 65 W. Va. 721, 63 S. E. 613 (1908); *Deveny v. Hart Coal Co.*, 63 W. Va. 650, 60 S. E. 789 (1908).

<sup>11</sup> 13 FLETCHER, CORPORATIONS §§ 5978-5984; (1908) 21 HARV. L. REV. 195.

<sup>12</sup> *Tierney v. United Pocahontas Coal Co.*, 85 W. Va. 545, 102 S. E. 249 (1920); *Crammer v. McSwords*, 24 W. Va. 595 (1883); *Felsenheld v. Bloch Bros. Tobacco Co.*, 192 S. E. 545 (W. Va. 1937).

<sup>13</sup> *Hope v. Valley City Salt Co.*, 25 W. Va. 789 (1885); *Tierney v. United Pocahontas Coal Co.*, 85 W. Va. 545, 102 S. E. 249 (1920); *Lamb v. Cecil*, 25 W. Va. 288 (1884), reversed 28 W. Va. 653 (1886); *Crumlish's Adm'r v. Shenandoah Valley R. R.*, 28 W. Va. 623 (1886); *Ravenswood, S. & G. R.*

acts of stockholders, there must be a case of fraud, misconduct amounting to fraud, insolvency of the corporation, or complete or substantial cessation of corporate activity.<sup>14</sup>

The mere fact of dealings between the corporation on one side, and a director or stockholder on the other, will not constitute a right of action,<sup>15</sup> although the directors are held to be fiduciaries of the corporation.<sup>16</sup>

A recent West Virginia case<sup>17</sup> raises several of these problems and discusses them at length, giving a valuable guide to our court's present position. In that case a large block of stock was held by three trustees under a will. A *cestui que trust* and one trustee sue the other two trustees as trustees and as directors of the corporation, for mismanagement of the trust, and as minority stockholders in a derivative suit. This comment deals only with the second theory of the suit.

The court held in an opinion by Judge Maxwell that the plaintiffs could maintain the suit on the ground of mismanagement of the corporation which materially reduced the assets thereof.<sup>18</sup>

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R. v. Woodyard, 46 W. Va. 558, 33 S. E. 235 (1899). Many of these cases involve the payment of unauthorized compensation to officers or directors. Some of them rely on a West Virginia statute [W. VA. ANN. CODE (Barnes, 1923) c. 53, § 53] forbidding unauthorized compensation of the president in the section providing for the office. This provision does not seem to have been included in W. VA. REV. CODE (1931), although c. 31, art. 1, § 18 purports to cover it. Maxon's Adm'r v. Maxon-Miller Co., 53 W. Va. 150, 44 S. E. 131 (1903); Goodin v. Dixie-Portland Cement Co., 79 W. Va. 83, 90 S. E. 544 (1916); Campbell v. King's Daughter General Hospital, 96 W. Va. 539, 123 S. E. 396 (1924). But see Watts v. W. Va. Southern R. R., 48 W. Va. 262, 37 S. E. 700 (1900). See also 5 FLETCHER, CORPORATIONS §§ 2109-2153.

<sup>14</sup> Smiley v. New River Co., 72 W. Va. 221, 77 S. E. 976 (1912); Ward v. Hotel Randolph Co., 65 W. Va. 721, 63 S. E. 613 (1908).

<sup>15</sup> Watts v. W. Va. Southern R. R., 48 W. Va. 262, 37 S. E. 700 (1900); Felsenheld v. Bloch Bros. Tobacco Co., 192 S. E. 545 (W. Va. 1937).

<sup>16</sup> Hope v. Valley City Salt Co., 25 W. Va. 789 (1885); Young v. Columbia Oil Co., 110 W. Va. 364, 158 S. E. 678 (1930). This case has been criticized for going too far in holding the directors trustees for the corporation. Note (1932) 38 W. VA. L. Q. 158. But it will be seen that this is the language used by other courts (3 FLETCHER, CORPORATIONS §§ 838-860) and that the application of the rule by our court does not work any hardship. See also State *ex rel.* Blackwood v. Brast, 98 W. Va. 596, 127 S. E. 507 (1925).

<sup>17</sup> Felsenheld v. Bloch Bros. Tobacco Co., 192 S. E. 545 (W. Va. 1937).

<sup>18</sup> There was a provision in the will limiting the control of the trust to one of the defendants for life, but it was held that he had by his misconduct taken the case out of the terms of the will. This point weakens the case as authority for the proposition that an equitable owner may bring a stockholder's suit. However, it is still a definite holding. The courts says (p. 547), "The doors of equity will not be closed to a *cestui que trust* merely because his interest in the corporation . . . is less direct than that of a legal stockholder . . . Many cases confirm the right of *cestuis que trust* to vindicate their rights in equity."

The three grounds of the suit were (1) loans to dominating directors; (2) acquisition of stock by dominating directors under an employee's stock subscription plan, and (3) excessive and gratuitous salaries paid to officers and directors of the corporation.

As to the loans, it was held that the action would not lie, in the absence of allegations to show fraud, or disadvantage to the corporation resulting from them, since loans to directors are not inherently wrong.<sup>19</sup>

The acquisition of stock under the employee's subscription plan provided a ground for a stockholder's suit, since it was a clear abuse of the plan, and amounted to misappropriation of funds, the purpose of the plan being to stimulate interest among employees in the corporation and its affairs, and therefore providing for issuance of the stock at very advantageous terms.

The excessive or gratuitous salaries paid to officers of the corporation constituted a ground for this type of suit if they were not previously authorized or agreed upon by the stockholders, but not otherwise. If such salaries were improperly paid, it amounted to a breach of the fiduciary duty of the directors to the corporation.<sup>20</sup>

It was also held that neither the Statute of Limitations nor the doctrine of laches applied, although some of the acts occurred as much as twenty-three years prior to the commencement of the suit, since the relation of trust and confidence existing between the defendants and the corporation made the affair one of which equity takes cognizance, and made applicable different rules as to the diligence which must be exercised in prosecuting the suit.<sup>21</sup>

The attitude of the West Virginia court on this subject, in so far as it has departed at all from the orthodox view, has been a realistic one, rather than consistently strict or liberal. The remedy is severely limited to start with, but where the restrictions tend to become mere formalities, they are immediately relaxed. The directors are held to be fiduciaries, but where they have business dealings with the corporation, they are upheld if they are actually fair, and there is no discrimination against a director beyond what

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<sup>19</sup> See cases cited *supra* n. 15.

<sup>20</sup> See discussion of this point *supra* n. 13.

<sup>21</sup> See cases cited *supra* n. 12.

is necessary for the corporate welfare. Our hardest problem, then, since our court is in substantial accord with the majority rule on all these points, is to discover exactly what that rule is, since it often appears that there are two equally strong rules on a point.<sup>22</sup>

C. A. P., JR.

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### DISJUNCTIVE ALLEGATIONS IN INDICTMENTS AND VARIANCE BETWEEN ALLEGATIONS AND PROOF

The Constitution of West Virginia, following in substance the provision of the Constitution of the United States<sup>1</sup> and the constitutions of the several states, guarantees that in trials of crimes and misdemeanors ". . . the accused shall be fully and plainly informed of the character and cause of the accusation . . ."<sup>2</sup> The reasons generally given for this provision are that the accused is entitled to know with certainty what offense is charged so that he may prepare an adequate defense and not be taken by surprise by evidence offered at the trial, and that he is entitled to have the offense so charged that upon acquittal or conviction he may plead the same in bar of a subsequent proceeding for the same offense and establish his plea by production of the former record.<sup>3</sup> This note will touch, in this connection, on disjunctive allegations in indictments and variance between allegations and proof.

Under such guaranty, most courts hold, and our court has held,<sup>4</sup> that an indictment<sup>5</sup> which charges an offense, using the

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<sup>22</sup> The recent United States Supreme Court case of *Ashwander v. Tennessee Valley Authority*, 297 U. S. 288, 56 S. Ct. 466 (1936) raises a question as to whether the court will follow *Dodge v. Woolsey*, 59 U. S. 331, 15 L. ed. 401 (1866) (a stockholder's suit lies to force the corporation to resist payment of any illegal tax, however slight in its effect), or *Hawes v. Oakland*, 104 U. S. 450, 26 L. ed. 827 (1881) (the exercise of sound business policy by the directors may not be complained of in a stockholder's suit, whether they have failed to enforce all corporate rights or not). It is probable that the West Virginia court, pursuing a realistic policy, would follow *Hawes v. Oakland*, which states a sound rule for the general welfare of the corporation. It has been cited with approval in several West Virginia cases. [*Rathbone v. Gas Co.*, 31 W. Va. 798, 8 S. E. 570 (1888).]

<sup>1</sup> U. S. CONST. Amend. VI.

<sup>2</sup> W. VA. CONST. art. III, § 14.

<sup>3</sup> *Berger v. United States*, 295 U. S. 78, 55 S. Ct. 629 (1935); *Clifford v. State*, 29 Wis. 327 (1871).

<sup>4</sup> *State v. Charlton*, 11 W. Va. 332, 27 Am. Rep. 603 (1877); *State v. Miller*, 68 W. Va. 38, 69 S. E. 365 (1910); *State v. Dawson*, 184 S. E. 253 (W. Va. 1936), the latter case holding that the full information must be in the indictment, and that what the accused may draw from adventitious circumstances does not count.